NOT INTENDED FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

In re	)	Chapter 7
	)	
SOSEBEE FREIGHT, INC.	)	Case No. 01-42006-mgd
	)	
Debtor.	)	Judge Diehl
	)	
R. Jeffrey Macleod, Trustee	)	Adversary Proceeding
	)	
Plaintiff,	)	No. 03-4024
	)	
v.	)	
	)	
First National Bank of Chatsworth,	)	
	)	
Defendant.	)	

ORDER GRANTING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT AND DENYING TRUSTEE'S MOTION FOR SUMMARY JUDGMENT

This matter is before the Court on cross-motions for summary judgment by Plaintiff R. Jeffrey Macleod, as Chapter 7 Trustee for Sosebee Freight, Inc. ("Trustee") and Defendant The First National Bank of Chatsworth ("Defendant"). The material facts are not in dispute and will be set forth in relevant detail below. Because the Court determines that the transfer of funds which effected payment of the overdraft in the account of Debtor was a transfer of earmarked funds, the Defendant's Motion for Summary Judgment is **GRANTED** and the Trustee's Motion for Summary Judgment is **DENIED**. Judgment will be entered accordingly.

FACTS

On September 18, 2001, Debtor Sosebee Freight, Inc. ("Debtor") filed a voluntary Chapter 7 case and R. Jeffrey MacLeod was subsequently appointed as Chapter 7 Trustee. On September 2, 2003, Trustee filed this action seeking to recover preferential transfer against Defendant. The preference complaint arises out of transfers involving Debtor's pre-petition checking account number 75021410 ("the Account") with Defendant.

On September 13, 2001, the Debtor's Board of Directors adopted a resolution authorizing the filing of a Chapter 7 case by Debtor. On September 14, 2001, the Debtor's Account had a negative balance of $127,731.56 as a result of Defendant honoring checks drawn on the account for which there were insufficient funds. These checks were for payment by the Debtor of ordinary business expenses. On that same day, Debtor's principal, Herman Talmadge Sosebee ("Sosebee") entered into a Promissory Note and Security Agreement with Defendant and $127,731.56 of the proceeds of the note were deposited directly into the Account. On September 18, 2001, Defendant applied the deposit to the overdraft balance to bring the account balance to zero.[1]

The Trustee contends that the setoff of funds by the Defendant to pay the overdraft was a transfer by the Debtor for or on account of an antecedent debt made while Debtor was insolvent that allowed Defendant to receive more than it would have received if the transfer had not been made and therefore avoidable as a preference under 11 U.S.C. § 547(b). The Defendant contests only the requirement of § 547(b)(5) that the transfer enable the creditor to receive more than it would have had the transfer not been made. Defendant contends that it was a fully secured

[1]Trustee has filed a separate adversary action in Sosebee's individual case to avoid the security interest of Defendant which was granted in connection with the loan at issue. This Order does not address the merits of that action.

creditor and therefore that the requirements of § 547(b)(5) were not met.

SUMMARY JUDGMENT STANDARD

Fed. R. Civ. P. 56 and Bankruptcy Rule 7056 provide for the granting of summary judgment if there is no genuine issue as to any material fact and if the moving party is entitled to judgment as a matter of law. *Celotex Corp. v. Catrett,* 477 U.S. 317, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986). In this case, neither party disputes the material facts relied upon by the other side. The difference is with respect to the legal implications of the undisputed facts.

Pursuant to Section 547(b) of the Bankruptcy Code, the Trustee must establish a transfer of *"an interest of the debtor in property* (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made (A) on or within 90 days before the date of the filing of the petition. . . and (5) that enables such creditor to receive more than such creditor would receive if (A) the case were a case under Chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title." (Emphasis added). *Union Bank v. Wolas,* 502 U.S. 151, 112 S. Ct. 527, 529-30 (1991).

Defendant argues that it is fully secured by virtue of O.C.G.A. § 11-4-210 which deals with the security interest of a collecting bank in items deposited for which credit has been given but has been withdrawn. In essence, this section deals with the practice of giving provisional credit for items deposited by a customer. If a bank allows its customer to write checks against a deposited item prior to its collection, the bank has a security interest in the proceeds of the deposited item and other sums that may be deposited until the provisional credit is repaid. The problem with Defendant's argument is, as the Trustee points out, the Defendant has offered no

evidence that the deficit in the account resulted from the giving of provisional credit for a dishonored item. Indeed, the undisputed fact, as contained in the affidavit of the Paul H. Ross, Chairman of the Board of Directors of Defendant, is that the negative balance resulted from Defendant honoring checks written by Debtor for ordinary business expenses. (Paragraph 5).

The Trustee has established all of the elements of a voidable preference, save one: that the transfer was of an interest of the debtor in property.[2] It is undisputed that the funds offset were placed in the account by Mr. Sosebee for the express purpose of payment of the overdraft. Indeed, the amount of the deposit into Debtor's account was the exact amount of the outstanding overdrafts. Thus, it is clear that the purpose of the transfer was specific to the repayment of the outstanding debt, a principal known as "earmarking" in preference law. See, e.g., *Emerson v. Federal Sav. Bank (In re Brown)*, 209 B.R. 874 (Bankr. W.D. Tenn. 1997).

The earmarking doctrine is a recognition that where a new lender makes a loan to enable a debtor to pay a specific creditor, those funds are "earmarked" for the creditor and the debtor has no control over the disposition of the funds. As such, they never become property of the debtor's estate and an essential element of a preference is missing. See *Coral Petroleum, Inc. v. Banque Paribas-London,* 797 F.2d 1351, 1356 (5th Cir. 1986). Under those circumstances, the estate has not been depleted because there has merely been a substitution of one creditor for another. *In re Superior Stamp & Coin, Inc.,* 223 F.3d 1004 (9th Cir. 2000).

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[2]While the Defendant contested the fact that debtor was insolvent at the time of the transfer, no evidence was offered to overcome the presumption of insolvency during the ninety day period prior to the filing of the petition so as to create an issue of material fact.

Here, prior to the transaction at issue,[3] Debtor owed Defendant $127,731.56 based on the overdraft. After the transaction, Debtor owed Mr. Sosebee (either as a loan or a return of capital) $127,731.56. The assets available for distribution to Debtor's unsecured creditors were not reduced as a result of the transfer at issue.[4]

There appears to be a difference of opinion within the courts as to whether the trustee has the burden of proving the non-applicability of earmarking [See *Tolz v. Barnett Bank (In re Safe-T-Brake)*, 162 B.R. 359 (Bankr. S.D. Fla. 1993)] or whether the creditor has the burden of proving its applicability [See *Wasserman v. Village Assocs. (In re Freestate Management Svcs., Inc.*) 153 B.R. 972, 981-2 (Bankr. D. Md. 1993)]. Since the Trustee has the burden of proving that the transfer was of property of the estate, it would appear that the reasoning of the *Safe-T-Brake* case is superior. Earmarking, according to this analysis "is a shorthand way of denying that what was transferred was an interest of the debtor in property." Id. at 365 citing *In re Interior Wood Products Co.,* 986 F.2d 228, 231 (8th Cir. 1993).

In the case before the Court, the undisputed facts establish that the funds which were transferred to Defendant as a result of the offset made to the Debtor's account were not property of the estate because they were funds which were earmarked for the re-payment of the overdraft in the bank account and Debtor did not have it within its control to direct those funds elsewhere. Indeed, the evidence establishes that the entire transaction was agreed to by Debtor, Mr. Sosebee

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[3]The transaction was a three-step transaction: Defendant loaned funds to Mr. Sosebee; Mr. Sosebee deposited those funds into the bank account of Debtor; and Defendant offset the balance of the account against the overdraft.

[4]Indeed, if the funds from Mr. Sosebee are found to be a capital contribution, unsecured creditors are actually better off as a result of the transactions.

and the Defendant for the express purpose of having Defendant make a secured loan to Mr. Sosebee to pay the unsecured loan to Debtor.[5]

It is therefore **ORDERED** that Defendant's Motion for Summary Judgment is **GRANTED** and the Trustee's Motion for Summary Judgment is **DENIED**. A separate judgment will be entered in accordance with this Order.

The Clerk's Office is directed to serve a copy of this Order upon the entities listed on the attached Distribution List.

This _____ day of December, 2004.

_____
Mary Grace Diehl
United States Bankruptcy Judge

[5]As indicated above, the allegations in the Trustee's Adversary against Mr. Sosebee in his individual Chapter 7 case are entirely different from what is set forth here, both as to theory of recovery and relevant facts. The allegations in that case include the fact that Defendant obtained a security interest in property of Mr. Sosebee in connection with this transaction. The net effect of the two transactions was to convert Defendant's unsecured claim against this Debtor into a secured claim against Mr. Sosebee. If the property transferred to Defendant in connection with the loan had been property of this estate, the result in this case would be different and the transfer would be avoidable to the extent of value of the security interest since that is the amount by which the estate would have been depleted.

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